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No. 88-922

In The

Supreme Court of the United States

October Term, 1988

KATHRYN A. HEILY,

Petitioner,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH INC. et al.,

Respondents.

On Petition For A Writ Of Certiorari To The California Court Of Appeal, First Appellate District

BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

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QUESTION PRESENTED

Whether a stockbroker, who is a registered representative with the New York Stock Exchange ("NYSE") and who has repeatedly agreed in writing to resolve any disputes with her employer pursuant to arbitration, may defeat a petition to compel NYSE arbitration on the ground that the as-yet-unknown NYSE arbitrators are presumptively biased against her personally or against stockbrokers generally in employment disputes.

PARTIES

The parties to the proceeding below were as follows: Petitioner Kathryn A. Heily was the petitioner before the California Court of Appeal. Respondents Merrill Lynch, Pierce, Fenner & Smith Inc.,* Paul F. Hayes and Peter F. Sansevero were "real parties in interest" before the California Court of Appeal. The Superior Court of the City and County of San Francisco was the respondent before the California Court of Appeal.

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* Pursuant to Supreme Court Rule 28.1, respondent Merrill Lynch, Pierce, Fenner & Smith Inc. reports that its parent company is Merrill Lynch & Co. Inc. and that its subsidiaries and affiliates are: Broadcourt Capital Corp.; Merrill Lynch & Co., Canada Ltd.; Merrill Lynch Life Agency, Inc.; Merrill Lynch Princeton Incorporated; Securities Option Corp.; and Wagner Stott Clearing Corp.

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A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

New York Stock Exchange Rule 347

Any controversy between a registered representative and any member or member organization arising out of the employment or termination of employment of such registered representative by and with such member or member organization shall be settled by arbitration, at the instance of such party, in accordance with the arbitration procedure prescribed elsewhere in these rules.

STATEMENT OF THE CASE

In 1968, petitioner Kathryn A. Heily ("Heily") was hired by respondent Merrill Lynch, Pierce, Fenner & Smith Inc. ("Merrill Lynch") to be a stockbroker. She first applied for registration with the New York Stock Exchange ("NYSE") that same year, and has been continuously registered with the NYSE, as well as other securities exchanges, ever since. As such, she is subject to the NYSE's rules, including Rule 347, which requires her (upon demand) to settle any employment disputes with Merrill Lynch by arbitration in accordance with the

NYSE's arbitration procedures. Moreover, between 1968 and 1982, Heily signed five separate documents requiring her to arbitrate disputes arising between her and Merrill Lynch.[1]

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[1] In 1968, in connection with her initial application for NYSE registration, Heily signed a form stating, *inter alia*:

> I agree that any controversy between me and any member or member organization or affiliate or subsidiary thereof arising out of my employment or the termination of my employment shall be settled by arbitration at the instance of any such party in accordance with the arbitration procedure prescribed in the Constitution and rules then obtaining of the New York Stock Exchange.

In 1974 and 1976, when opening her own option accounts at Merrill Lynch, Heily signed forms stating, *inter alia*:

> Any controversy between us arising out of such option transactions or this agreement shall be settled by arbitration before the National Association of Securities Dealers, Incorporated, or the New York Stock Exchange, or the American Stock Exchange, only.

The arbitration clause went on to give Heily five days to elect the forum of her choice among the three available, after which Merrill Lynch would have the right of election.

In 1978, in connection with her application for registration with various exchanges in various states, Heily signed a form stating, *inter alia*:

> I agree to abide by the statute(s), constitution(s), rule(s) and bylaw(s) as any of the foregoing are amended from time to time of the agency, jurisdiction or organization with or to which I am filing or submitting this application.

(Continued on following page)

In 1987, just such a dispute arose. Heily, alleging that she had been wrongfully discharged by Merrill Lynch as a result of her actions in connection with index option trading by customers serviced by her and others, filed suit in the Superior Court for the City and County of San Francisco against Merrill Lynch and two of its employees. Defendants promptly petitioned the Superior Court to compel arbitration of all of Heily's claims before the NYSE.

Heily opposed the arbitration petition vigorously, with the benefit of thorough discovery.[2] Her principal argument to the Superior Court was that the agreements she had signed were "unconscionable," and therefore unenforceable, because the as-yet-unknown arbitrators that would be selected to hear her claims before the NYSE were likely to be biased against an employee in a dispute between an employee and a brokerage firm.

(Continued from previous page)

And 1982, in connection with yet another application for registration, Heily signed a form stating, *inter alia*:

> I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm . . . that is required to be arbitrated under the rules, constitutions or bylaws of the organizations with which I register.

While the 1978 and 1982 applications do not themselves specify NYSE arbitration, they both require Heily to comply with NYSE Rule 347, which expressly provides for NYSE arbitration of disputes between registered representatives and brokerage firms.

[2] A total of 147 pages of briefs were filed in connection with the petition to compel arbitration, accompanied by 27 declarations and excerpts from four pre-hearing depositions.

Heily relied upon *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 171 Cal. Rptr. 604, 623 P.2d 165 (1981), which had held, as a matter of state law under the California Arbitration Act,[3] that an arbitration clause in an adhesion contract may be unconscionable and therefore unenforceable where "it designates an arbitrator who, by reason of its status and identity, is presumptively biased in favor of one party." 28 Cal. 3rd at 821.

Factually, Heily based her bias argument on a New York *Times* article and five declarations from persons who had served as NYSE or National Association of Securities Dealers, Inc. ("NASD") arbitrators, including Heily herself. Each of the declarants expressed his or her opinion that NYSE (and NASD) arbitrators were likely to favor brokerage firms in disputes with employees.[4]

In addition to her bias theory, Heily argued to the Superior Court that Merrill Lynch had "unclean hands" and that the arbitration agreements she had signed were

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[3] Cal. Civ. Proc. Code §§ 1280-1294.2 (West 1982 & Supp. 1988).

[4] Of the five declarants, only *two* had actually served as NYSE arbitrators in disputes between brokerage firms and their employees. And even those two failed to identify *any* specific instances of actual bias in an employment dispute. Instead, the declarations contained generalized, conclusory charges, amounting to no more than the declarants' *opinions* that panelists tend to be biased against individual employees in disputes with big brokerage firms. *None* of the declarants admitted to having rendered biased decisions him- or herself, and, needless to say, *none* of them was able to state that the panelists selected to hear Heily's claims would be biased in any way.

"fraudulently induced." The unclean hands argument was a curious mix of unsubstantiated factual allegations and twisted logic.[5] As for the fraudulent inducement theory, it boiled down to Heily's contention that she had never read the five arbitration agreements she had signed, and therefore should be excused from complying with them.

In reply, Merrill Lynch noted that Heily's presumptive bias argument was faulty in that (among other things) it relied exclusively on California arbitration law. Merrill Lynch pointed out that under controlling federal precedent, derived from both the Federal Arbitration Act, 9 U.S.C. §§ 1 *et seq.* ("FAA"), and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.* ("1934 Act"), the NYSE is an adequate arbitration forum as a matter of law. Merrill Lynch also took on Heily's "evidence" of bias, pointing out the deficiencies in the five declarations on which she relied, and submitting persuasive evidence – both testimonial and statistical – of the procedural and

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[5] Heily's allegation that Merrill Lynch had pressured one of her co-workers not to help her prosecute her lawsuit was not only false but completely unrelated to the arbitration agreements and hence to the petition to compel arbitration. The fact that the NYSE's arbitration director submitted a declaration in defense of the system he oversaw tended to prove nothing more sinister than the NYSE believes its arbitration process to be fair and just. And the independent decision of the NASD arbitration director to suspend Heily's five declarants from NASD arbitration panels until she could investigate their sudden charges of bias (never brought to the NASD's attention before) was not only justified but totally irrelevant to Heily's claim that *Merrill Lynch's* unclean hands barred it from seeking *NYSE* arbitration.

substantive fairness of NYSE arbitration. As for Heily's other two theories, Merrill Lynch demonstrated that the facts established by the record did not amount to either an unclean hands or a fraudulent inducement defense under California law.

On June 10, 1987, two days after this Court decided *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S.Ct. 2332 (1987), the Superior Court heard oral argument on the petition to compel arbitration. (The transcript of that hearing is reprinted herein as Appendix F ["App. F"].) The judge commented that she had "never seen so much paper," but stressed that she "did read all these things," including "every word" of the five declarations from the securities arbitrators. App. F at 3-5. Addressing herself at greatest length to Heily's bias argument, the judge held that federal law governs the issue of the presumptive fairness of the NYSE as an arbitration forum, and that "under [f]ederal law, it's an appropriate forum." *Id.* at 4. She also discussed and rejected Heily's fraudulent inducement claim on the facts, under California law. *Id.* at 3. Ultimately, the court granted the arbitration petition without specifically discussing Heily's unclean hands contention, and ordered Heily to arbitrate her dispute before the NYSE.

A month later, Heily moved for reconsideration of that order. This time she argued that an ongoing investigation by the enforcement division of the NYSE of her performance while at Merrill Lynch was further "evidence" of presumptive bias against her by the not-yet-selected arbitrators who would hear her claim against

Merrill Lynch.[6] And she suggested that, if she were forced to arbitrate, she be permitted to do so before the American Arbitration Association ("AAA"), even though none of the arbitration agreements she signed even mentioned the AAA as a possible forum. She also contended that a footnote in this Court's just-announced opinion in *Perry v. Thomas*, 482 U.S. 483, 107 S.Ct. 2520 (1987), suggested a radical change in judicial interpretation of the FAA and required the trial court to apply California arbitration law – specifically, the *Graham* case – to her claim that the NYSE is a presumptively biased arbitration forum. Heily did not ask the court to reconsider its rulings on her unclean hands or fraudulent inducement claims. Once again, the issues were thoroughly briefed and each party submitted evidence.[7]

The reconsideration motion was heard on August 25, 1987. (The transcript of the August 25 hearing is

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[6] Heily had known about the investigation since before she brought her lawsuit. She has never explained why she failed to raise it as an issue until she moved for reconsideration of the Superior Court's original order.

[7] A total of 44 pages of briefs were filed in connection with the reconsideration motion, accompanied by three declarations and excerpts from two depositions. Despite her charge that Merrill Lynch had acted improperly in submitting the declaration of an NYSE official during the earlier proceeding, Heily supported her reconsideration motion with a solicited declaration from the AAA's Regional Director. Of course, according to her own logic, the AAA's willingness to "side" with Heily was conclusive evidence that any AAA arbitration panel would be biased in her favor and therefore could not be entrusted with the arbitration of her claims against Merrill Lynch.

reprinted herein as Appendix G ["App. G"].) The judge explained at the outset that she still believed Heily's bias claim was governed by federal law, and therefore that she would not change her original ruling. App. G at 2-3. The judge also pointed out that, despite Heily's insistence on using the term "actual bias," her arguments – at best – went to the issue of presumptive or institutional bias:

> I agree with counsel for Merrill Lynch that your remedy under federal law is to attack the arbitration award, when and if that occurs, as being biased or that she was incapable of receiving a fair hearing.
>
> But I think that is a record that has got to be made in front of the arbitrators, not in front of the law and motion judge. I don't think I can decide *in futuro* that the New York Stock Exchange is incapable of giving Ms. Heily a fair hearing.

Id. at 8. The petition for rehearing was denied.

Heily next argued her claims before the California Court of Appeal. The appellate panel, in a published opinion issued June 20, 1988, declined to disturb the trial court's factual rulings on Heily's fraudulent inducement or unclean hands claims, but carefully examined her presumptive bias argument. The court began with the proposition that, under the FAA as interpreted by this Court in *Perry*, the enforceability of an arbitration agreement is a matter of federal law, except that general state law contract principles may be applied to determine the enforceability of the contract containing the arbitration clause. The court then determined that the arbitral-bias principle enumerated in *Graham* was *not* a general state law contract principle and hence could not be applied to the five agreements Heily had signed. *Heily v. Superior Court*, 202 Cal. App. 3d 255, 260, 248 Cal. Rptr. 673, App. A at 5

(1988). Turning to federal cases instead to judge the adequacy of the NYSE as an arbitration forum, the court agreed with a recent Ninth Circuit case, *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282 (9th Cir. 1988), holding that the NYSE is an adequate arbitration forum as a matter of federal law. 202 Cal. App. 3d at 262-263, App. A at 8.

Heily's petition for a review of the Court of Appeal decision in the California Supreme Court was denied, and she thereupon petitioned this Court for a Writ of Certiorari.

REASONS FOR DENYING THE PETITION

Kathryn Heily's Petition to this Court is but the latest chapter in her relentless attempt to utilize every conceivable legal mechanism to avoid or delay arbitration of her claims against Merrill Lynch. Relying on advocacy more notable for its vigor than its clarity, Heily has never hestitated to misrepresent the record in her effort to put off the day of reckoning when she must expose the merits of her case to a factfinder's scrutiny. Her Petition to this Court pursues the same strategy. In her attempt to engage this Court's attention, she argues for Supreme Court review of questions that are simply not presented by the decision of the Court of Appeal or the record below.

Section I of this brief reveals that Heily's fraudulent inducement and unclean hands arguments were disposed of below under California law as applied to the facts of this case, and are therefore not suitable for Supreme

Court review. As for her contention that this case presents broad issues of Due Process as applied to arbitration proceedings, Section II of this brief demonstrates that neither the trial court rulings nor the Court of Appeal opinion purports to impose the wholesale ban that Heily fears on judicial consideration of bias in arbitration proceedings.

Stripped of its hyperbole and read against the record made in the California courts, Heily's Petition presents only one narrow question potentially cognizable by this Court on a Writ of Certiorari. That question is whether her presumptive bias challenge to the adequacy of the NYSE as an arbitration forum was properly rejected under federal law. As Section III of this brief demonstrates, two separate lines of well-settled Supreme Court precedent compel the conclusion that it was.

I. HEILY CANNOT PRESENT HER "UNCLEAN HANDS" AND "FRAUDULENT INDUCEMENT" CLAIMS TO THIS COURT, BECAUSE THEY WERE DISPOSED OF BELOW ON THE FACTS, UNDER STATE LAW.

Heily raised three objections below to Merrill Lynch's arbitration petition: presumptive bias, unclean hands, and fraudulent inducement. As to all three claims, Heily submitted evidence and asked the trial court to apply California law to that evidence. As to all but the bias claim, that is exactly what the court did.

Contrary to Heily's charge that "[t]he trial court refused to consider Heily's evidence," Petition at 4, the transcript of the June 10, 1987 hearing reveals that the judge not only read all of the parties' submissions but

commented on their length, saying, "I remember as if I had been reading this for the last month of my life." App. F at 3. And contrary to Heily's representation that the trial court held that the FAA "preempts all state-law challenges," Petition at 4, the record establishes something very different. The trial judge forthrightly addressed the choice-of-law issue at the outset of the hearing, and announced,

> Under the state of the law as it exists now and as I see it, whether an arbitration clause is enforceable is determined by Federal law *except to the extent that the contract itself is unenforceable under State law.*

App. F at 3 (emphasis added).

The court obviously recognized Heily's unclean hands and fraudulent inducement arguments as going to the enforceability of "the contract itself," and therefore applied state law to the evidence presented on both sides of those claims. As to the fraudulent inducement issue, the court explicitly stated during the hearing that the substance of it, "Ms. Heily's claim that she never read any of these five agreements . . . is not a ground *under the facts of this case* or *under California law* to set aside the contract . . . ." The court then distinctly ruled that "there was *no fraud in the inducement*" of the arbitration agreements Heily signed. App. F at 3 (emphasis added). While the unclean hands argument was not specifically addressed at the hearing, both parties had briefed the issue under California law as applied to the evidence adduced in this case. There is no reason to assume that the Superior Court's rejection of Heily's unclean hands defense was based on anything else.

Significantly, when Heily moved for reconsideration of the original arbitration order, she argued that the *Perry v. Thomas* footnote required the court to apply state law to her *bias* claim. She did *not* ask the court to reconsider its fraudulent inducement and unclean hands rulings – thus implicitly acknowledging that those rulings had already been made based on the evidence adduced and California law.

The Court of Appeal, recognizing that the Superior Court had considered and rejected Heily's fraudulent inducement and unclean hands arguments on the evidence, refused to reconsider those issues. In fact, it chastised Heily for attacking the trial court's factual rulings without even advising the appellate court of "the considerable evidence contrary to her positions." *Heily v. Superior Court*, 202 Cal. App. 3d at 263, App. A at 8. Heily has repeated that mistake in her Petition to this Court, and has compounded it by misrepresenting the record below so as to make it appear that the trial court rejected her fraudulent inducement and unclean hands claims on federal preemption grounds.

This Court does not sit to review factual determinations made by a state court applying state law. *California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.*, 445 U.S. 97, 111 (1980) ("we customarily accept the factual findings of state courts"); *Skelly Oil Co. v. Phillips Petroleum Co.*, 339 U.S. 667, 674 (1950) ("we do not reexamine the local law as applied by the lower courts"). No matter how unhappy Heily is with the failure of her fraudulent inducement and unclean hands defenses below, she has no right to present them to this Court for review.

II. HEILY CANNOT PRESENT HER BROAD DUE PROCESS CLAIMS TO THIS COURT, BECAUSE THEY ARE NOT RAISED BY THE RECORD BELOW.

Heily would like this Court to believe that the decision below, if permitted to stand, would "mandate[] that evidence of bias in an arbitration system was inadmissible and beyond judicial consideration in deciding whether to compel arbitration." Petition at 12. In fact, Heily has grossly distorted the rulings of both the Superior Court and the Court of Appeal.

Merrill Lynch never argued – and the lower courts never ruled – that the fairness of an arbitration forum is immune from any and all judicial scrutiny on a petition to compel arbitration. Instead, Merrill Lynch argued – and the lower courts agreed – that the question of the presumptive bias of an arbitration forum must be addressed under *federal law*. Thus, the trial court held that the adequacy of the NYSE as an arbitration forum "is a matter of *[f]ederal law*." App. F at 3 (emphasis supplied). Similarly, the Court of Appeal engaged in a searching analysis of the question of NYSE bias, but was careful to do so under *federal law*. *Heily v. Superior Court*, 202 Cal. App. 3d at 260-63, App. A at 5-8.

Nor did Merrill Lynch argue – or the lower courts rule – that federal law protects every arbitration forum from presumptive bias challenges. Instead, Merrill Lynch contended – and the lower courts so held – that *the NYSE in particular* is a presumptively fair arbitration forum as a matter of federal law. Merrill Lynch's argument, as accepted by the Superior Court and the Court of Appeal,

was premised on the fact that the NYSE's arbitration procedures are subject to oversight and approval by the Securities and Exchange Commission ("SEC") under the 1934 Act. *See* Section III of this brief, *infra*.

And finally, Merrill Lynch was always careful to point out – as were the lower courts – that a claim of *actual* rather than presumptive bias in the operation of an NYSE arbitration panel may be raised on appeal from an arbitration decision. *See* 9 U.S.C. § 10(b) and (c) (court may vacate an arbitration award where "there was evident partiality or corruption in the arbitrators" or "[w]here the arbitrators were guilty of . . . any . . . misbehavior by which the rights of any party have been prejudiced"). If indeed the arbitrators to be appointed by the NYSE to hear Heily's claim are biased against her, she will have every opportunity to place evidence of that bias before a court. What the courts below have not permitted her to do is to avoid arbitration before a forum that is presumptively adequate under federal law by making a premature, speculative claim that a decision not yet rendered, by arbitrators not yet appointed, will be infected by bias against her.

The decision below simply cannot be manipulated to stand for any proposition broader than that those few arbitration forums overseen and approved by the SEC under the 1934 Act are not subject to pre-arbitration challenges based on state law principles of presumptive arbitral bias. Properly understood, the decision below is not only consistent with, but mandated by, clear Supreme Court precedent.

III. BOTH THE 1934 ACT AND THE FAA INSULATE THE NYSE FROM HEILY'S ATTACK.

Heily's obligation to arbitrate her claims against Merrill Lynch stems from two interrelated sources. The first is NYSE Rule 347, promulgated pursuant to the Securities Exchange Act of 1934, which requires her, as a former employee of Merrill Lynch, to arbitrate her claims against the brokerage firm. The second is the Federal Arbitration Act, which requires courts to enforce the five arbitration agreements that she signed. The Court of Appeal's refusal to permit Heily to raise a state law challenge to the adequacy of NYSE arbitration was not only consistent with, but compelled by, both the 1934 Act and the FAA.

A. The 1934 Act Preempts State-Law Challenges To The Adequacy Of The NYSE As An Arbitration Forum.

Section 19 of the 1934 Act, 15 U.S.C. § 78s, gives the SEC broad regulatory authority over the securities exchanges, including the NYSE. Since 1975, when Congress amended Section 19 to enhance that authority, the SEC has been charged with, and has exercised, the responsibility to review the NYSE's rules and regulations for fairness and consistency with the objectives of the 1934 Act itself.

Thus, under Section 19(b)(1), the NYSE must submit any proposed rule changes to the SEC. 15 U.S.C. § 78s(b)(1). Upon the filing of any proposed rule change, the SEC must publish notice of the proposed change and provide interested parties an opportunity to comment. *Id.* Subject to certain exceptions, no proposed rule change may take effect unless approved by the SEC. *Id.* Under

Section 19(b)(2), the SEC must grant such approval, but only if it finds after notice and comment that the proposed rule is consistent with the requirements of the 1934 Act and with the rules and regulations thereunder. 15 U.S.C. § 78s(b)(2). Moreover, under Section 19(c), the SEC may on its own initiative "abrogate, add to, and delete from" any rule if it finds such changes necessary or appropriate to further the purposes of the 1934 Act. 15 U.S.C. § 78s(c).

In sum, Congress has by statute delegated to the SEC the responsibility and duty of ensuring the fairness of the NYSE's rules and regulations. The SEC, in turn, has exercised that responsibility and duty and approved the SEC's rules, *including* Rule 347, which requires a stockbroker to arbitrate any disputes "arising out of [her] employment or termination of employment," *and* Rules 600-634, which set out the actual arbitration procedures to be used by the NYSE in such a case. Thus, the NYSE rules requiring Heily to arbitrate her dispute with Merrill Lynch and prescribing the procedures to be used at the arbitration all operate pursuant to delegated Congressional authority under the 1934 Act. Where a contrary state principle conflicts with this Congressionally-authorized regulatory scheme, the state law must yield as a matter of federal preemption. *See Fidelity Federal Savings & Loan Assoc. v. De La Cuesta*, 458 U.S. 141, 153 (1982) ("Federal regulations have no less preemptive effect than federal statutes"); *Sola Electric Co. v. Jefferson Electric Co.*, 317 U.S. 173, 176 (1942) (state common-law rules, like state statutes, are subject to federal preemption).

Merrill Lynch is well aware of the fact that, in 1973, this Court held that Rule 347 and the NYSE's arbitration rules did *not* preempt a California statute guaranteeing

employees the right to maintain a court action for back wages. In *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Ware*, 414 U.S. 117 (1973), this Court declined to hold that the NYSE's rules preempted state law. However, the decision in *Ware* was explicitly based, in part, on the fact that, in 1973, Rule 347 and the arbitration procedures prescribed for use in employee-employer disputes were *not* subject to SEC oversight. 414 U.S. at 134-35. Fourteen years later, this Court again acknowledged that the lack of SEC oversight over Rule 347 at the time of the *Ware* decision was a major factor in the decision not to hold state law preempted. *Perry v. Thomas*, 482 U.S. at ___, 107 S.Ct. at 2525-26.

In 1975, as mentioned above, Section 19 of the 1934 Act was amended to give the SEC increased authority over the securities exchanges. The 1975 amendments constituted the "most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act in 1934." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 384-85 (1983) (quoting Securities Act Amendments of 1975: Hearings on S. 249 before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess., 1 (1975)). They explicitly granted the SEC the authority to amend *any* NYSE rule, including Rule 347 and the rules prescribing arbitration procedures, if necessary to ensure the adequacy and fairness of the arbitration system or otherwise further the purposes of the 1934 Act.

In point of fact, the SEC has heavily involved itself since 1975 in promoting the effective and fair resolution of disputes through NYSE arbitration. For example, in

1977 the SEC played a key role in the formation of the Conference on Arbitration, which was created to develop a uniform arbitration code. *See* Implementation of an Investor Dispute Resolution System, Exchange Act Release No. 13470, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) 81,136 (April 26, 1977). That Conference drafted the Uniform Code of Arbitration which has since been expressly approved by all of the Conference's members, including the NYSE. *See* In the Matter of New York Stock Exchange, Inc., Exchange Act Release No. 16390, 18 S.E.C. Docket 1197 (November 30, 1979).

Two recent opinions of this Court hint broadly that the 1975 amendments to Section 19 would be sufficient to tip the *Ware* balance the other way, were the question directly presented, and require a holding that, under the current 1934 Act, the NYSE's arbitration rules preempt contrary state law. Thus, in *Shearson/American Express, Inc. v. McMahon*, this Court held that agreements to settle claims arising under Section 10(b) of the 1934 Act, 15 U.S.C. 78j(b), by arbitration before the NYSE, are enforceable. In reaching that conclusion, this Court depended heavily upon the assurance, provided by SEC oversight, that NYSE arbitration procedures are fair and adequately protect the parties' rights. 482 U.S. at ___, 107 S.Ct. at 2341. And in *Perry v. Thomas*, this Court explained that *Ware* had been premised on "[t]he fact that NYSE Rule 347 was outside the scope of the SEC's authority" in 1975. 482 U.S. at ___, 107 S.Ct. at 2526. The *Perry* opinion then went on to sidestep the question of pure 1934 Act preemption and to base its holding – that the same California statute at issue in *Ware* must give way – on "the preemptive effect of the Federal Arbitration Act . . . ." *Id. See* Section III(B) of this brief, *infra*.

In *Cohen v. Wedbush, Noble, Cooke, Inc.*, the Ninth Circuit faced claims almost identical to Heily's. The appellants in that case had attempted to sue a brokerage firm in court and to avoid arbitration by claiming, *inter alia*, that the NYSE and the NASD would be presumptively biased against them. Like Heily, the Cohens relied on California law to support their position that a claim of presumptive arbitral bias could exempt them from their obligation to arbitrate. The Ninth Circuit looked to this Court's opinion in *Shearson/American Express* for guidance, and found it:

> As the Supreme Court has recognized, the Securities and Exchange Commission has virtually plenary authority over the arbitration procedures adopted by the national securities exchanges and securities associations. This authority includes the power to "abrogate, add to and delete from" the arbitration rules adopted by such bodies if necessary or appropriate to protect the rights created by the Securities Acts. The SEC has explicitly approved the NYSE and NASD arbitration rules and procedures at issue in this case. Because Congress has committed to the SEC the task of ensuring that the federal rights established by the Securities Acts are not compromised by inadequate arbitration procedures, we are bound by the Commission's determination that the procedures at issue here are satisfactory.

Cohen, 841 F.2d at 286 (citations omitted). The Ninth Circuit went on to conclude that, "[A]greements to arbitrate disputes in accordance with SEC-approved procedures are not unconscionable as a matter of law." *Id.*[8]

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[8] *Cohen* has also been followed by the Northern District of California in *Western Hospitals Federal Credit Union v. E. F. Hutton & Co.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,990 (N.D. Cal. 1988).

Cohen's conclusion, which was followed by the Court of Appeal in the case at bar, is virtually compelled by this Court's recognition, in *Shearson/American Express*, that the NYSE's arbitration rules, as they stand today, are the product of delegated Congressional authority under the 1934 Act. If principles of federal preemption do *not* safeguard those procedures from state-law attacks on their fairness, then the uniform, nationwide dispute resolution system carefully crafted by the SEC would fall into a shambles. The enforceability of an agreement to arbitrate before the NYSE (or any other exchange subject to SEC oversight) would vary from state to state. In fact, the enforceability of such an agreement could well vary from *case* to *case*, depending on the persuasiveness and credibility of the witnesses enlisted to testify or submit declarations in each action.

A rule permitting such piece-mail evaluation would be illogical as well as unworkable. An NYSE arbitration panel is either presumptively fair or it is not. Congress has delegated the task of ensuring its fairness to the SEC, and this Court has recognized that the SEC has done its job. Therefore, the *Cohen* court – and the Court of Appeal in the case at bar – were absolutely correct to rule that state law principles cannot be used to challenge the presumptive fairness of NYSE arbitration on a case-by-case basis.

B. The FAA Also Preempts State-Law Challenges To The Adequacy Of The NYSE As An Arbitration Forum.

Heily's obligation to arbitrate her dispute with Merrill Lynch stems not only from NYSE Rule 347 but also

from the Federal Arbitration Act, which provides that written arbitration agreements – such as the five agreements Heily signed – "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. It is by now well-settled that, "The effect of this section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983). Thus, the Supreme Court has consistently held that an arbitration agreement enforceable under the FAA cannot be avoided by the application of conflicting state law. *E.g., Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984) (FAA preempts provision of California law guaranteeing judicial determination of claims under the state's Franchise Investment Law); *Perry v. Thomas*, 482 U.S. at ___, 107 S.Ct. at 2526 (FAA preempts provision of California law guaranteeing judicial determination of wage disputes). *See also Liddington v. The Energy Group, Inc.*, 192 Cal. App. 3d 1520, 238 Cal. Rptr. 202 (1987) (FAA preempts provision of California law permitting a stay of arbitration proceedings pending judicial resolution of related litigation).

Heily claims that her state-law challenge to NYSE arbitration is not preempted by the FAA because the FAA does "*not* preempt general principles of state law which might affect the enforcement of an agreement to arbitrate," Petition at 7, and because the principles enumerated in *Graham v. Scissor-Tail*, on which she bases her challenge, "appl[y] generally to any kind of contract." *Id.* at 10.

Merrill Lynch does not dispute Heily's contention that general state-law contract principles may be applied to contracts governed by the FAA. Nor did the Court of Appeal. But the lower court did recognize that the same paragraph of *Perry v. Thomas* acknowledging the applicability of general state contract law also sharply defined what "general" means:

> [S]tate law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally. A state law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2. A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law. Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot.

482 U.S. at ___, 107 S.Ct. at 2527 n.9 (citations omitted).

The arbitral-bias principle enunciated in *Graham v. Scissor-Tail*, as the Court of Appeal recognized, did *not* arise "to govern issues concerning the validity, revocability and enforceability of contracts generally." It was developed especially for, and applied exclusively to, arbitration contracts. Nor is the *Graham* case simply a specific application of general California unconscionability doctrine, as Heily would have this Court believe. Indeed, under ordinary California contract law, a

contract is not rendered unenforceable due to unconscionability unless it was unconscionable "at the time it was made." Cal. Civ. Code § 1670.5 (West 1985). In *Graham*, the California Supreme Court created a special unconscionability rule, applicable only to arbitration contracts, which apparently permits courts to consider the presumptive bias of an arbitration forum as of the time the contract is sought to be enforced. Moreover, as the Court of Appeal pointed out, *Graham* "weav[es] together principles of adhesion contracts and state statutes governing the neutrality of arbitrators." *Heily v. Superior Court*, 202 Cal. App. 3d at 260, App. A at 5. In short, the *Graham* arbitral-bias principle that Heily seeks to rely on "takes its meaning precisely from the fact that a contract to arbitrate is at issue," *Perry v. Thomas*, 482 U.S. at ___, 107 S.Ct. at 2527 n.9, and therefore cannot be applied to an arbitration contract under the FAA.[9] *See also Downs v. Prudential-Bache Securities, Inc.*, 202 Cal. App. 3d 616, 248 Cal. Rptr. 734 (1988) (adequacy of NYSE as an arbitration forum must be judged under federal law rather than *Graham* and its progeny).

Heily does not contend that *federal* law renders the arbitration agreements she signed unconscionable due to any presumptive bias of the NYSE arbitrators. Nor could she, given the approval of the NYSE's arbitration procedures by the SEC under the 1934 Act, as discussed in

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[9] To the extent that Heily's Petition may be read to contend that the Court of Appeal wrongly interpreted *Graham*, she is without recourse in this Court. *See Tibbs v. Florida*, 457 U.S. 31, 46-47 (1982) (state court's construction of prior state court decision ordinarily "binds this Court").

Section III(A) of this brief, *supra*. *See also Thomas v. Perry*, 200 Cal. App. 3d 510, 515, 246 Cal. Rptr. 156 (1988) (on remand from this Court, the Court of Appeal held, "existing federal precedent finds the [NYSE's] arbitration rules not to be unconscionable or presumptively biased"). Thus, under the FAA as well as the 1934 Act, the Court of Appeal was absolutely correct to rule that Heily's state-law challenge to the adequacy of the NYSE as an arbitration forum was out of order, and that the NYSE is a presumptively fair forum as a matter of federal law.

CONCLUSION

As the foregoing sections demonstrate, the instant case presents a very narrow question to this Court. That question was decided correctly below, based upon clear federal precedent from two separate sources. There is no need for any correction or clarification by this Court. Accordingly, respondents respectfully submit that Heily's Petition for Writ of Certiorari should be denied.

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APPENDIX F

IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA IN AND FOR THE CITY AND COUNTY OF SAN FRANCISCO BEFORE THE HONORABLE LUCY KELLY-McCABE, JUDGE
DEPARTMENT NO. 26

—000—

KATHRYN A. HEILY,
Plaintiff,
vs.
MERRILL LYNCH PIERCE FENNER & SMITH, INC., PAUL HAYES, PETER SANSEVERO, and DOES ONE through FIFTY,
Defendants.

No. 868892

MOTION TO COMPEL ARBITRATION

REPORTERS TRANSCRIPT OF PROCEEDINGS

June 10, 1987

APPEARANCES:

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BY: W. REECE BADER, ESQ.
and
JAY M. CUTLER, ESQ.

Reported by: Janice L. Davis
CSR No. 3899

WEDNESDAY, JUNE 10, 1987 10:30 a.m.

THE COURT: Line 27, Heily versus Merrill Lynch.

MR. BADER: Good morning, your Honor. W. Reece Bader and Jay Cutler, Orrick, Herrington & Sutcliffe, on behalf of the defendant and moving party.

MR. STEVENS: Shand Stevens appearing for the plaintiff, Kathryn Heily, who is on my right.

MR. BADER: Your Honor, in view of the tentative ruling, I will reserve my time to respond to counsel's argument.

I do have one inquiry, your Honor. There was also a Motion for Stay of Proceedings on file. I assume the tentative ruling with respect to granting the Petition to Compel would also include granting the stay of proceedings.

THE COURT: Correct.

MR. BADER: Thank you.

MR. STEVENS: Your Honor, this is, from the plaintiff's point of view, an extremely significant part of her lawsuit.

THE COURT: I know. You told me everything at least three times. I have never seen so much paper.

MR. STEVENS: I think only half of it was mine.

THE COURT: Here is my analysis in an attempt to focus this. This clearly is a matter of Federal law. Under the state of the law as it exists now and as I see it, whether an arbitration clause is enforceable is determined by Federal law except to the extent that the contract itself is unenforceable under State law.

Since that is the law in my view, it is irrelevant for purposes of this motion what procedures are used by NASD or the New York Stock Exchange because under Federal law, those have been determined to be appropriate remedies.

So what I looked at – and I don't have my notes here, but I remember as if I had been reading this for the last month of my life. The contract of adhesion – well, first Ms. Heily's claim that she never read any of these five agreements, which is not a ground under the facts of this case or under California law to set aside the contract, the Court found that there was no fraud in the inducement of both the employment contract, the application of the securities for registration or the option trading agreements.

That's all I can think of right now. You claim there is no consideration. I didn't agree with that.

What am I forgetting?

MR. STEVENS: Your Honor, we have submitted the declarations from five arbitrators from the New York

Stock Exchange, the American Stock Exchange and NASD.

THE COURT: I read every word of those and it was real interesting and I got out of the market immediately. But under Federal law, it's an appropriate forum.

If I find that the contract itself is enforceable, I don't think, as a State court, I can even look at that. Do you all disagree with that?

MR. BADER: No, your Honor.

MR. STEVENS: Well, of course that is their position.

THE COURT: No. I just want to make sure I wasn't misstating –

MR. STEVENS: Your Honor, that simply is not true, and if the – The question is whether or not the Court is entitled to look at whether or not the forum is, in fact, unconscionable, whether it is unconscionable to enforce the arbitration provision by sending this plaintiff back. The authority directly on point, which is 1986 *Lewis vs. Prudential-Bache*, says that.

Under the Federal Arbitration Act, an arbitration clause can be revoked on any legal or equitable ground that allows revocation of the contract, including unconscionability. In other words, under Federal law, unconscionability of the arbitration clause is a ground for revocation. So that there is no question that you can consider that. That is the thrust of our argument, that it is.

THE COURT: Unconscionability of what?

MR. STEVENS: The arbitration clause is unconscionable because it will force the plaintiff to adjudicate an employment dispute in an arbitration forum where the arbitrators themselves are biased against low-level employees such as the plaintiff in wrongful termination disputes.

THE COURT: I understand that that's your position.

MR. STEVENS: Well, I must admit that the entire case in this context is extremely troublesome to this particular lawyer who works in a large law firm and represents many large corporate clients and this is an unusual experience for me to deal with an individual plaintiff.

The facts as I see them, your Honor, are that we had five arbitrators who had tremendous experience in the system. They have had over 340 arbitrations between them. All swear to this Court that arbitrators in these securities forums are biased against employees such as the plaintiff and they cited separate reasons, each of them for several conclusions that they drew, not the least of which was that the panelists are mostly management and, therefore, they are biased against non-management plaintiffs in arbitrations.

The arbitrators tend to give more credibility to management witnesses than they do to employees. For that same reason it is common in a securities industry for these managers to change jobs and to –

THE COURT: I read all this. I mean I did read all these things.

MR. STEVENS: Well, your Honor, I understand that, and these people who swore that these things were true, who had participated in the arbitration system somewhere between thirty and eight years, were all fired within four days after that evidence was submitted to the Court.

THE COURT: See, what you didn't argue and what you didn't ask for and what I considered doing was the Prudential-Bache Court says, "Well, the arbitration clause is enforceable, but since the forum is biased, then go to Triple A arbitration," but don't want that either; correct?

MR. STEVENS: Your Honor, quite frankly, I would prefer to be sent to Triple A arbitration than I would to a forum – I mean I am not here spending my time and the Court's time with this simply because I'm trying to do an abstract exercise.

THE COURT: Nobody addressed that aspect of that case and I'm well aware of the case and the Court did not really enter into the analysis of whether the problem with the forum – The Court ordered that, it seems to me, more as an equitable remedy and this is sort of the Court's discretion. If you're going to do this, it may be an inappropriate arbitrator, but there is nothing wrong with the clause.

I did not view that case as not giving me jurisdiction to send it off to a forum that's specified in the agreement and the reason – since you didn't argue for it, I didn't spend very much mental activity on it; and secondly, I think that as a matter of Federal law, I probably cannot do it anyway.

MR. STEVENS: Well, your Honor, may I address the last first.

The question of the ability of the Court do do that, and if – *Lewis* vs. *Prudential-Bache*, once again, which is cited on Page 12 of our brief and it's 179 C.A.3d 935, and *Lewis* vs. *Merrill Lynch* stand for the proposition that you can do that.

First of all, they address the question of whether unconscionability is a defense under the Federal Arbitration Act and they clearly conclude that it is.

THE COURT: Unconscionability of the original contract is, agreed. I agree with that, but I don't agree with your argument that because there's a problem with the forum, that that relates back to the inception of the contract and makes the contractual provision unenforceable.

MR. STEVENS: The question is whether it's unconscionable to enforce agreement, and I am actually moving in the direction of your Honor's suggestion, and that is that if your Honor is inclined or believes that it would be appropriate to send it to Triple A arbitration rather than securities arbitration, I would like to have that done.

THE COURT: Well, nobody argued it, so I'm not prepared to do it right now.

MR. STEVENS: Would it be possible, then, your Honor, to delay this for 15 or 20 days in order to raise that point, because Lewis clearly – The Court of Appeal did that on its own in Lewis.

THE COURT: Let me ask counsel what he thinks about Lewis, which wasn't really in this monumental sacrifice to this case since it wasn't really addressed by

you or by them except as to other propositions set forth in Lewis.

MR. BADER: Your Honor, my response would be with respect to this question of unconscionability, that even – what Ms. Heily is really saying here in connection with the declarations that they submitted is that she has a premature claim of institutional bias on the part of arbitrators not yet selected in an arbitration not yet held that will be conducted in the future.

In our response, we confronted head-on the declarations that were submitted, and as your Honor is also aware, we filed a motion to strike certain aspects of those declarations.

The point is those declararions offer no specific examples of actual bias, and under Federal law, particularly the Drayer case or the Tonetti case in the Court of Appeal, the question is resolved only on a showing of actual bias.

In addition, I think from the declarations we submitted, we provided specific factual examples refuting that bias and specific results directed at that aspect of the unconscionability argument that Ms. Heily, according to her, would not have a fair and reasonable opportunity to prevail, and I think, given the record that exists – and I don't know of anything more, quite frankly, that could be added to the record at this point in time – there is no showing.

THE COURT: No reply to the reply to the reply?

MR. BADER: There is no showing of actual bias, and again, your Honor, I come back. What counsel is saying is that somehow there's going to be a presumed bias. That, in fact, is not the case. As your Honor has recognized as a matter of law, that won't be the case, and if, in fact, there is actual bias in conjunction with the subsequent arbitration of this proceeding before the New York Stock Exchange, an arbitrator selected by them, there are going to be numerous procedural devices by which the plaintiff can raise those issues.

We referred to the ruse [sic] in our reply brief and I won't get into them now. Suffice it to say, given the involvement of both the Exchange and the NASD in this particular case, it strikes me that an extraordinary effort of care and consideration is going to go into the selection of those arbitrators and the plaintiff is going to have ample opportunity to question whether they, in fact, are appropriate arbitrators for this case.

The contract deals with arbitration under the auspices of the New York Stock Exchange or the NASD, and we believe that the contract, as your Honor believes, is enforceable and that we are entitiled to proceed to arbitration before, as we have selected in Ms. Heily's absence in selecting a forum, the New York Stock Exchange and we do not believe that the matter should be referred to the Triple A for arbitration and we further see no reason really to delay this proceeding any further.

MR. STEVENS: Well, your Honor, it is untrue that the particular forum is specified and it is also clearly the fact that your Honor can send it to Triple A arbitration if

you choose, because that's exactly what Lewis did. The Court of Appeal has already adopted that particular middle road for dealing with this kind of a problem.

The plain fact of the matter is that your Honor knows that the remedies with respect to arbitration, and once it's happened, are extremely limited. The grounds for appealing are extremely limited, and, in fact, your Honor, I must admit that my concern about this case being adjudicated in those forums is immensely heightened by what we have now done, which is the head of the direction of the New York Stock Exchange has seen all these declarations, including one from my own client, and has submitted a declaration to this Court in which he indicates how offended he is at the notion that his system is biased and now we're supposed to go to that very system and adjudicate our claim where it's come to the attention of its highest levels.

Not only that. Within a couple of hours of the NASD discovering that declarations had been submitted to this Court, every arbitrator who submitted declarations for the plaintiff was summarily dismissed, so I can't see how, in light of the fact that these competent and reputable people are willing to say that in an employment dispute of this kind with a low-level employee, the securities arbitration is unfair; that it is fair, in fact, to send it to that forum.

The only agreement that there is at all, if there is one, is to arbitrate, and it can be arbitrated under the Triple A rules if your Honor so chooses, and that would be much preferable to doing it in front of this forum and it would solve all of Merrill Lynch's problems. They say it's

cheaper to arbitrate and it probably is and that's the advantage, but the advantage should not be, your Honor, where we're adjudicating in front of a forum where we won't get a fair and impartial hearing or a fair result.

MR. BADER: I'm not sure, your Honor, that I can really add anything more to what I've said.

THE COURT: I want to hear what objections you would have to Triple A arbitration.

MR. BADER: Two. First of all, in *Lewis* vs. *Prudential-Bache*, which is a customer case, the customer agreement had several alternative forums, or had at least a Triple A alternative in addition to the New York Stock Exchange and the NASD forum. That's not present in this case with respect to the options account agreements signed by Ms. Heily and it is not an alternative forum with respect to the application form RE-1 and the two U-4's.

Secondly, your Honor, one of the significant purposes of securities industry arbitrations in this context, which was just reiterated two day ago by Justice O'Connor in *American Express* vs. *McMahon* in which the Court upheld in the customer context arbitration arising under section 10 of the '34 Act an arbitration of RICO claims, was the fact that – two facts: the involvement of the FCC [sic] with respect to all of the rules and regulations of the regulatory organizations as well as its specific approval of the arbitraton procedures, which would be applicable here, and secondly, a basic purpose behind the securities industry arbitration in the context of a case like this involving disputes between employees of brokerage firms and those brokerage firms is the expertise that is

brought to bear by having experienced arbitrators deal with it. I'm not sure that's the case with AAA in conjunction with the panels of arbitrators that they have.

And lastly, again, we believe the contract is enforceable according to its terms and ought to be submitted to the New York Exchange for arbitration.

THE COURT: Submitted by both of you?

MR. STEVENS: Yes, your Honor.

THE COURT: The tentative is adopted. The Petition to Compel Arbitration is granted. This action is stayed pending arbitration.

With regard to the – Since you're going to have to prepare the order with regard to the Labor Code claim, I was totally convinced by Judge Lynch's opinion.

MR. STEVENS: Your Honor, is it to be sent to AAA arbitration?

THE COURT: It's to be sent to their election.

MR. BADER: New York Stock Exchange.

Your Honor, there's one other matter. Mr. Stevens just before we came in here –

MR. STEVENS: I have not filed that and I don't intend to.

MR. BADER: All right. I'll withdraw that.

THE COURT: All right.

(Whereupon, the proceedings were concluded.

APPENDIX G

IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA IN AND FOR THE CITY AND COUNTY OF SAN FRANCISCO BEFORE THE HONORABLE LUCY KELLY MC CABE, JUDGE

—000—

KATHRYN A. HEILY, PLAINTIFF,	)	
VS.	)	CASE NO. 868892
MERRILL LYNCH, ET AL., DEFENDANTS.	)	

—000—

REPORTER'S TRANSCRIPT

AUGUST 25, 1987

—000—

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OFFICIAL COURT REPORTER: NOREEN T. IKEUYE, C.S.R.
CERTIFICATE NO. 3538

—000—

AUGUST 25, 1987 9:30 CALENDAR

PROCEEDINGS

—000—

THE COURT: Line 11, *Heily* v. *Merrill Lynch.*

I should make it clear before you begin, I did reconsider it. But I decided not to change my mind. I mean, I didn't decide this on procedural grounds. I looked at the reasons. I denied the reconsideration based on *Perry*, and the new First District – what is the name of that real recent case somebody talked about?

MR. STEPHENS: *Lewis* v. *Merrill Lynch?*

THE COURT: No.

MR. BADER: *Liddington.*

THE COURT: Yes, the Energy Power case.

It seems to me that federal law is now really clear that once there's coverage by the Federal Arbitration Act, the only state law defenses to arbitration that are available are what would be defenses to any contract.

What you have asked me to do is to decide that only the forum selection clause is unconscionable. At this point, given what I have decided in the first place – that this contract was not unenforceable because of unconscionablility, and that under federal law this clause is enforceable. And for that reason, I am declining to change the ruling on the motion to compel arbitration.

MR. STEPHENS: May I discuss it with you for a moment?

THE COURT: Sure.

MR. STEPHENS: The let me take it in two steps. *Perry v. Thomas*, which was decided 5 days after your honor ruled on the motion, specifically says that state law principles of general applicability to contract apply to these arbitration agreements. Are you and I agreed as to that?

THE COURT: Yes. Also section 2 of the Federal Arbitration Act says that, too.

MR. STEPHENS: Right. Now, I don't agree that what that means in this particular case is that we are attacking something that specifically relates only to arbitration. Unconscionability relates in the larger context to all contracts.

THE COURT: Agreed.

MR. STEPHENS: All right. There are two issues then before the court.

First of all, is this actually a forum selection clause? And the answer is no, there is not. And that is particularly evident from the fact that we quoted the language out of them. And Merrill Lynch chooses not to rely on

them, saying there is a forum selection clause in the arbitration provision we have quoted for your Honor on page 2.

THE COURT: Yes.

MR. STEPHENS: And if you look at the 1982 application, which is the last one signed, it says – and I will leave – try to leave some of the words out so you can get to the thrust of it – "I agree to arbitrate any dispute that is required to be arbitrated under the rules, constitutions or bylaws of the organizations with which I register."

Now what that means is if those rules require something to be arbitrated, I agree to do that. It doesn't say that it must be before the New York Stock Exchange or any other particular place.

And so I believe that, your Honor, in this situation, under both the Federal Arbitration Act, Section 5, and general state law, the court has the power to choose where to send it.

THE COURT: Except the effect of that is to incorporate the rules of whatever exchange she is required to register with.

MR. STEPHENS: But I mean – I agree that I understand perhaps that that is what you are saying. But if you focus on the language, it doesn't mandate that result at all. And if it's not mandated, then the choice rests with the court to do that, even –

THE COURT: Let me hear from counsel for Merrill Lynch on that point.

MR. BADER: On that specific issue, your Honor?

THE COURT: Yes.

MR. BADER: Well, I don't have the exact agreements in front of me. They are part of the record from our earlier hearing.

THE COURT: Part of our problem – Well, I didn't go through –

MR. BADER: Yes. I didn't –

THE COURT: I have trusted my memory about what he had the last time, as I recall.

MR. BADER: The agreements.

THE COURT: There are 5 agreements.

MR. BADER: Yes, there are 5.

THE COURT: And this – excuse me a second. Is this particular language from –

MR. BADER: The 1982 agreement.

THE COURT: Okay.

MR. STEPHENS: It is the last agreement that was signed that relates to the entire complaint.

MR. BADER: The first agreement which was the original RE-1 application in 1968 where it first refers specifically to Rule 374 of the New York Stock Exchange – Rule 347 requires arbitration of employment disputes. That rule has not changed. That rule therefore, as your Honor indicated, becomes incorporated in the subsequent agreements.

The reference to "organizations with which I register" – they are all securities industry organizations – the

exchanges, the NASD. That is also true with respect to the options, the two options agreements as well, whether it's NASD or New York Stock Exchange. So it's clearly a securities industry forum.

We petitioned to compel; plaintiff made no response, no elections, with respect to a forum. Rather, plaintiff challenged the process wholesale. We asked that the agreements be enforced as mandated by the Arbitration Act, and that the New York Stock Exchange be the proper forum.

I don't think there is anything new or different or any valid reason which presently exists to change that ruling.

THE COURT: I understand that's your position.

MR. STEPHENS: Your Honor, you have the power to choose the forum for this particular plaintiff. The only right under that contract that exists, if one does at all, is to force arbitration, not to choose the forum where it is to occur.

The language, doesn't dictate that. And it is untrue that any of these agreements which I have quoted for your Honor, on page 2, mention Rule 347 of the New York Stock Exchange. They do not.

You have the power then under the United States Supreme Court decisions, the Federal Act, *Lewis v. Merrill Lynch* and *Liddington* which parrots *Perry* – it says that state law principles apply. You have the power to choose the forum. There is no necessity for sending it to a place

where there is any doubt about whether or not the plaintiff will receive a fair hearing. There is every reason to send it somewhere where she will.

Whether there is no such doubt in the particular case here, since the choice exists, and since a particular place for doing this is not required by the agreement, there is every reason to do it, and no reason not to. Because the issue is one at the heart of American jurisprudence – will she receive an unbiased, impartial hearing of what she has to say? Regardless of whether she wins or loses, she is entitled to that at least.

The importance of this issue to the defendant is indicative of the fact that that forum is an advantage to Merrill. They have obviously seen it that way, or they wouldn't be here fighting so hard not just for arbitration, but now they are fighting real hard to send it where they want it sent.

Why? Is there any difference between there and here with respect to the discovery or the rules or procedure? They don't cite you any of that. They say we have a right to send it there, your Honor, and that is where we want it. But they don't have that right. They don't even have an election to do that. It's not their choice. It is your Honor's choice. The contract doesn't mandate that choice.

THE COURT: I don't agree with you. I don't think I have got that choice. After *Perry*, I don't think I have got that choice. Federal law, which nobody got into in these papers because it's 3 steps removed from where we are now, but the federal law as to the enforceability of forum selection clauses is pretty clear.

I view the language you quoted as incorporating the rules of the exchanges that she registers with. I agree with counsel for Merrill Lynch that your remedy under federal law is to attack the arbitration award, when and if that occurs, as being biased or that she was incapable of receiving a fair hearing.

But I think that is a record that has got to be made and in front of arbitrators, not in front of the law and motion judge. I don't think that I can decide *in futuro* that the New York Stock Exchange is incapable of giving Ms. Heily a fair hearing. That is my view of where we are in the law as of 3 weeks ago.

MR. STEPHENS: In going through the Federal Act and then reading that law, in accord with *Perry* v. *Thomas* as well as our own appellate court decisions, it's clear –

THE COURT: The only appellate court decision you have got is *Lewis*.

MR. STEPHENS: Okay.

THE COURT: Right? Agreed? That really has to do with what we are doing here?

MR. STEPHENS: It's directly on point, yes. And it holds that the forum selection clause in one of Merrill Lynch's customer agreements is unconscionable because that forum is presumptively biased – not even by biased, presumptively biased in industry-wide dispute.

THE COURT: *Lewis* involves a case where it was undisputed that every single brokerage firm used a 360 day year for computing interest.

MR. STEPHENS: Correct.

THE COURT: That was undisputed, right?

MR. STEPHENS: Yes, there was an allegation.

THE COURT: So there is really no dispute of fact at all about whether the arbitrators could put that out of their minds or, you know, not be even presumptively biased but actually biased.

We have nothing like that here. We have something tending – you have submitted evidence that may tend to show that there may be bias, but it's not like *Lewis*.

MR. STEPHENS: Well, but the specific facts of *Lewis*, I don't believe, are actually what is important with respect to this proceeding.

What is important is the fact that the court in *Lewis* recognizes, and that is a 1986 decision, that the Superior Courts of this state have the power to hold that, number one, even though an arbitration clause is enforceable, the forum selection may not be. And that is severable.

And that severing out the forum choice, the court then has the power to order arbitration in a neutral forum. And in that case, *Lewis* v. *Merrill Lynch*, I mean this situation was some other neutral forum, that is, the American Arbitration Association. There is simply no doubt that the court has the power to do this. It exists both under federal and state law, your Honor.

The federal law, the Federal Arbitration Act in section 2 talks about the agreements, and about the fact that state law defenses are applicable. And then in section 5 it says, if there is a forum selection clause, that should be

enforced. Obviously, reading the 2 sections together, the forum selection is subject to an attack under state law.

And the bottom line, your Honor, is that addressing the equity of a situation – to the court's equitable powers, there is no reason to require the plaintiff to arbitrate in a forum where there is even a reasonable doubt of any kind that she will receive a fair hearing.

In the end, as your Honor knows, attempting to attack an arbitration award after an arbitration is very very difficult. The standards for doing that are extremely limited – bad faith and dishonesty on the part of the arbitrator is extremely difficult to prove.

What we have presented your Honor with is the up front evidence from 5 different arbitrators, to the effect that their experiences in all of these systems put together, tell them that in this kind of a dispute, a wrongful termination case, there is unfortunately a bias that exists against the plaintiff. And why incur that risk? Someone with an 18 year career is entitled to the limited benefit of an impartial hearing. And that is all that is being requested here, the particular forum, which your Honor has the power to do.

THE COURT: I don't agree that I do. But I guess we will find out whether I do or not.

MR. STEPHENS: I suppose so, your Honor.

MR. BADER: Your Honor, I did prepare a proposed form of order. I have not shown it to Mr. Stephens. It's very straightforward.

THE COURT: Show it to Mr. Stephens.

MR. STEPHENS: If it's represented to be straightforward, I'd better read it carefully.

THE COURT: Oh, gentlemen.

MR. STEPHENS: That is fine.

MR. BADER: May I approach the bench?

THE COURT: Yes.

MR. STEPHENS: Thank you for your time.

THE COURT: Thank you for your papers. It was an interesting question.

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